

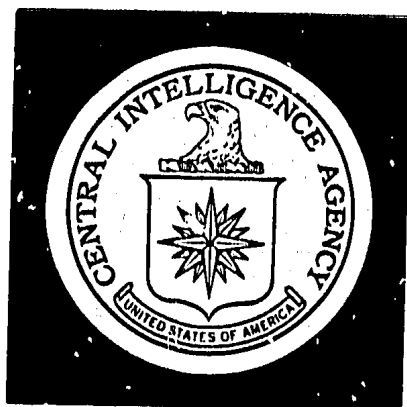
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Cambodia's Short-Term Economic Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1970

INTELLIGENCE MEMORANDUM

Cambodia's Short-Term Economic Prospects

Introduction

Vietnamese Communist incursions since March have created critical economic problems for the Cambodian government. Defense costs have skyrocketed while wartime destruction and dislocations have retarded the production and transport of commodities, causing drastic reductions in foreign exchange earnings and government revenues. Although inflation has not yet reached serious proportions, the pressures are building. The purpose of this memorandum is to examine the impact of the war on the Cambodian economy thus far and to assess the prospects for the economy to mid-1971.

The Economic Impact to Date

Population Dislocations and Loss of Territory

1. The principal economic impact of the war to date has been the loss of substantial portions of territory to the Communists and the uprooting of large segments of the population. The Communists have gained control over areas normally containing about 30% of population and food production potential, the principal rubber plantations, and a few industrial plants. More than one-half million people -- 10% of the population -- have become refugees. At least 200,000 ethnic Vietnamese have

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

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been evacuated to South Vietnam or are in camps awaiting evacuation as a result of anti-Vietnamese sentiment stimulated by the hostilities. Many of these were shopkeepers, skilled laborers, and fishermen whose importance to the Cambodian economy was greater than their numbers suggest. There has been an influx of possibly 400,000 persons from war-torn or Communist-controlled areas into Phnom Penh.

Disruption of Transportation

2. Enemy interdiction of the rail line and continued harassment of road and river traffic have drastically retarded the movement of agricultural commodities to port for export and have reduced to a trickle the flow of international maritime trade via the Mekong through Phnom Penh. The government's requisitioning of civilian trucks for military service has further complicated the transport problem.

3. None of the major lines of communication radiating from Phnom Penh has escaped at least temporary interdiction since March. Enemy harassment of shipping on the Mekong resulted in a virtual three-month suspension beginning in late April of maritime trade through Phnom Penh, which last year handled about one-quarter of Cambodia's seaborne trade. Traffic at this port has increased over the past two months but is still far below pre-March levels. Through traffic has been continuously interdicted since April from Phnom Penh to Cambodia's other maritime port at Kompong Som by rail and via Routes 2 and 3. Traffic on Route 4, Phnom Penh's only other link to the port, has been subjected to repeated interdictions and harassment and has often been limited to armed convoy movements during daylight hours. Similarly, traffic eastward on Route 1 to Saigon has been largely limited to armed convoys moving only by day. The railroad to the northwestern provinces and Thailand has been interdicted since June at a point about 35 miles from Phnom Penh (limiting traffic to the sections between Phnom Penh and Bat Doeng and between Pursat and the Thai border). Route 5, which serves essentially the same areas, has suffered occasional interdictions. Routes 6 and 7 to the north and northeast have long been unsafe for civilian traffic beyond 30 or 40 miles from Phnom Penh. Additionally, all telecommunications lines between major cities have been cut.

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Agriculture

4. Food is plentiful in spite of the war. An exceptional rice crop in the 1969/70 crop year -- about 3 million tons* of paddy -- left larger than usual stocks of rice in the hands of both the government and the population. Before the war intensified, a surplus of some 450,000 tons of milled rice for export was expected. Actual exports through early October, however, totaled only about 139,000 tons, indicating that surplus stocks may be quite sizable. As of late August, the government reportedly had 140,000 tons of rice in Phnom Penh that were originally intended for export, and there are probably substantial stocks of surplus rice in most towns and on the farms. These stocks are probably ample to cover both civilian and military needs for many months,** although localized shortages could develop because of road interdictions.

5. Aside from the effects of loss of territory to the Communists, a substantial reduction in rice planting during the past summer will tend to reduce the 1970/71 rice harvest. The Communists are reported to have prevented some peasants from planting in Prey Veng and Kompong Cham Provinces and to have intimidated farmers in Battambang Province. Additionally, ARVN operations have interfered with farming in Svay Rieng and Prey Veng Provinces. Tentative Cambodian estimates indicate that plantings were down 10% to 20% in relatively secure Battambang, and about 20% on the average for government-controlled areas, with greater reductions in some other areas.

6. Rubber production has fallen sharply. Most of the large Kompong Cham rubber plantations, the sites of heavy US/ARVN operations early in the war, are under Communist control and often serve as Viet Cong sanctuaries. Only about 5% of the rubber trees have reportedly suffered bomb and shrapnel damage, but rubber-processing facilities have been virtually

* All tonnages in this memorandum are in metric tons.

** For example, 140,000 tons of rice are sufficient to feed the prewar population of Phnom Penh for more than a year or an expanded 200,000-man army for more than three years.

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wiped out and production brought to a halt. Cambodia normally produces about 50,000 tons of rubber annually, and rubber exports normally account for one-fifth to two-thirds of total export value. Only 18,000 of an expected 46,000 tons have been exported thus far this year, most of it in the first quarter.

7. Corn production has also been unfavorably affected by the war because the main corn-growing area between Phnom Penh and Neak Luong was the site of considerable fighting during the planting period. Corn is Cambodia's third most important export, although comprising only about 5% of total exports. A sizable portion of the coming crop is presumed lost, and export availabilities are likely to be small. Also, the production of forest products, another important export, has declined because of insecurity in major forest lands.

8. The fish catch, mainly from the Tonle Sap, probably has fallen because of the expulsion of Vietnamese fishermen, but there is no evidence of prolonged shortages either of fish or meat in Phnom Penh. If prices of these products should rise substantially, the illegal flow of Cambodian beef cattle to Saigon would probably be reduced and sales to Phnom Penh increased.

Industry

9. The loss of output in Cambodia's embryonic industrial sector is of relatively minor consequence to the economy. Although virtually all of Cambodia's industrial capacity is located in government-controlled areas -- the paper mill at Chhlong being the only important exception -- that sector has been greatly affected by the hostilities. Of the large-scale plants, only the petroleum refinery and the sugar and textile plants are still operating. War damage or VC presence has brought production to a halt at the Tuk Meas fertilizer plant, the Chhlong paper mill, and the 50,000-ton-per-year Chakrey Ting cement plant, which supplied one-third of Cambodia's cement needs.

10. A general industrial slowdown has been occasioned by the difficulties in bringing materials to plants and delivering finished goods to markets,

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by labor shortages induced by the rapid expansion of the army and the Vietnamese evacuation, and by the requirements that factories form self-defense units from their labor force. Moreover, the textile plants are now producing khaki for military uniforms rather than civilian fabrics. The refinery at Kompong Som has twice been forced to shut down for periods of two weeks because the plant's storage tanks became filled when refined products could not be securely transported to Phnom Penh. No serious petroleum shortages have developed, however.

Tourism

11. The Communist occupation of Angkor, the fighting at Siem Reap, the poor state of transportation, and the general insecurity have temporarily eliminated tourism as a source of foreign exchange. Upwards of 46,000 foreigners visited the temple ruins at Angkor and the picturesque capital last year. Their spending -- about \$2 million* in 1969 -- will be only partly supplanted by that of ARVN soldiers.

Foreign Trade

12. The value of exports in 1970 had originally been projected at about \$96 million, about 85% of which consisted of rice, rubber, and corn. Because of the war-induced disruption, the Cambodians in July revised their projected total downward to about \$46 million. No more than about \$25 million worth of exports were shipped in the first half of the year, however, and exports since then have been minimal so that even the revised figure now appears too high.

13. Cambodia's imports normally run about \$100 million annually, of which about 15% are capital goods, 40% are consumer goods, 20% are materials for the consumer industry, and 25% are for government uses and capital goods industries. Imports are government-controlled, and controls have been tightened since the outbreak of hostilities. The government had ample stocks of imported goods on hand when hostilities began and has conserved foreign

* All US dollar figures are calculated at the official exchange rate of 55.5 riels = US \$1.

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exchange by drawing on these stocks while severely curtailing nonessential imports. Foreign exchange allocations to the private sector amounted to less than \$100,000 from June through September. Imports for all of 1970 will probably amount to about \$45 million -- only half of the original estimates.

14. Owing to the strict control of foreign exchange, reserves stood at \$67 million as of mid-October 1970 -- or at about the same level as at the end of March. Only about \$16 million of these reserves are in liquid form. About \$40 million* reportedly are blocked in medium-term investment contracts until December 1970, and about \$11 million are held in nonconvertible currency.**

Government Finance

15. More than half of government revenues are normally derived directly or indirectly from imports. Taxes and other levies add about 60% to the CIF value of imports. About 40% of government revenues are derived from tariffs and other taxes on imports, and another 35% to 40% stem from various taxes on sales and business income, about half of which involve imported goods. Revenues from government services, other government enterprises, and the state lottery account for another 15% to 20% of revenues. There are no significant taxes on exports.

16. Peacetime budgets normally allocated expenditures roughly equally among defense, government administration, and economic development. The original 1970 budget projected total spending on the order of \$177 million, with the usual one-third for defense. Only \$19 million in loans and advances were to be required to finance the expected deficit. However, war and mobilization have almost doubled

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These include between \$8 million and \$9 million worth of assets of the defunct Indochina Institute d'Emission that France has held since 1955 pending an agreement on their distribution between Cambodia, Laos, and South Vietnam.

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government expenditure projections and have more than tripled defense allocations. With revenues expected at roughly half of the original projections, a massive deficit is inevitable.

Money and Prices

17. Conservative fiscal and monetary policies over the years have kept prices remarkably stable. The failure of the money supply to keep pace with the growth in population and national income in recent years has thus far facilitated the absorption of a war-induced infusion of riels without serious inflation. The inflationary impact has also been lessened by abundant supplies of basic foodstuffs and considerable stocks of imported goods. The government's practice of delaying payments -- even military salaries -- in recent months has also slowed the impact. Prices of some commodities, notably rice, vegetables, fruit, meat, and charcoal, have risen by as much as 100% at times, but these increases have been temporary and the result of local shortages rather than any significant inflationary trend.

18. In view of projected government deficit spending, well in excess of \$200 million over the next 12 months, however, strong inflationary pressures can be anticipated. Inflation is unlikely to have a great impact on the majority of the populace who live on farms and are largely self-sufficient. The inflationary pinch will be concentrated on the 10% to 20% of the population living in cities.

Foreign Aid

19. Cambodia has received large-scale military aid commitments only from the United States -- nearly \$50 million to date, with a possibility for substantially more before the end of FY 1971. Modest amounts of military equipment have been received from South Vietnam, Thailand, Nationalist China, [REDACTED]

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20. Cambodia's pleas for economic assistance have so far gone largely unheeded. Japan has offered nearly \$4 million worth of humanitarian aid, but Cambodia's request for \$20 million in economic aid has thus far fallen on deaf ears. France has delivered 20 trucks under an earlier

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agreement, but the Cambodians have not openly pressed for deliveries under a \$22.7 million agreement signed in January 1970 for fear that administrative debate regarding allocation of the funds would turn into a forum for the vilification of France in its failure to support the Cambodian government. Economic aid is still under consideration by the United States, and minor offers of economic and humanitarian aid have been made by Australia, New Zealand, and Denmark.

Economic Prospects Through June 1971General

21. The Cambodian economy will be influenced by the security situation, by the Cambodian government's own military and economic policies, and by the availability of foreign economic assistance. It is fairly certain that next year agricultural production will be down, exports will be only a small fraction of normal levels, and government expenditures for military purposes will be far higher than this year. Without foreign aid, this will mean a low capacity to import and extremely strong inflationary pressure. A sizable foreign assistance program could substantially reduce these pressures, but some degree of inflation appears to be inevitable because of the increase in demand for services and service goods that can be provided only from local sources.

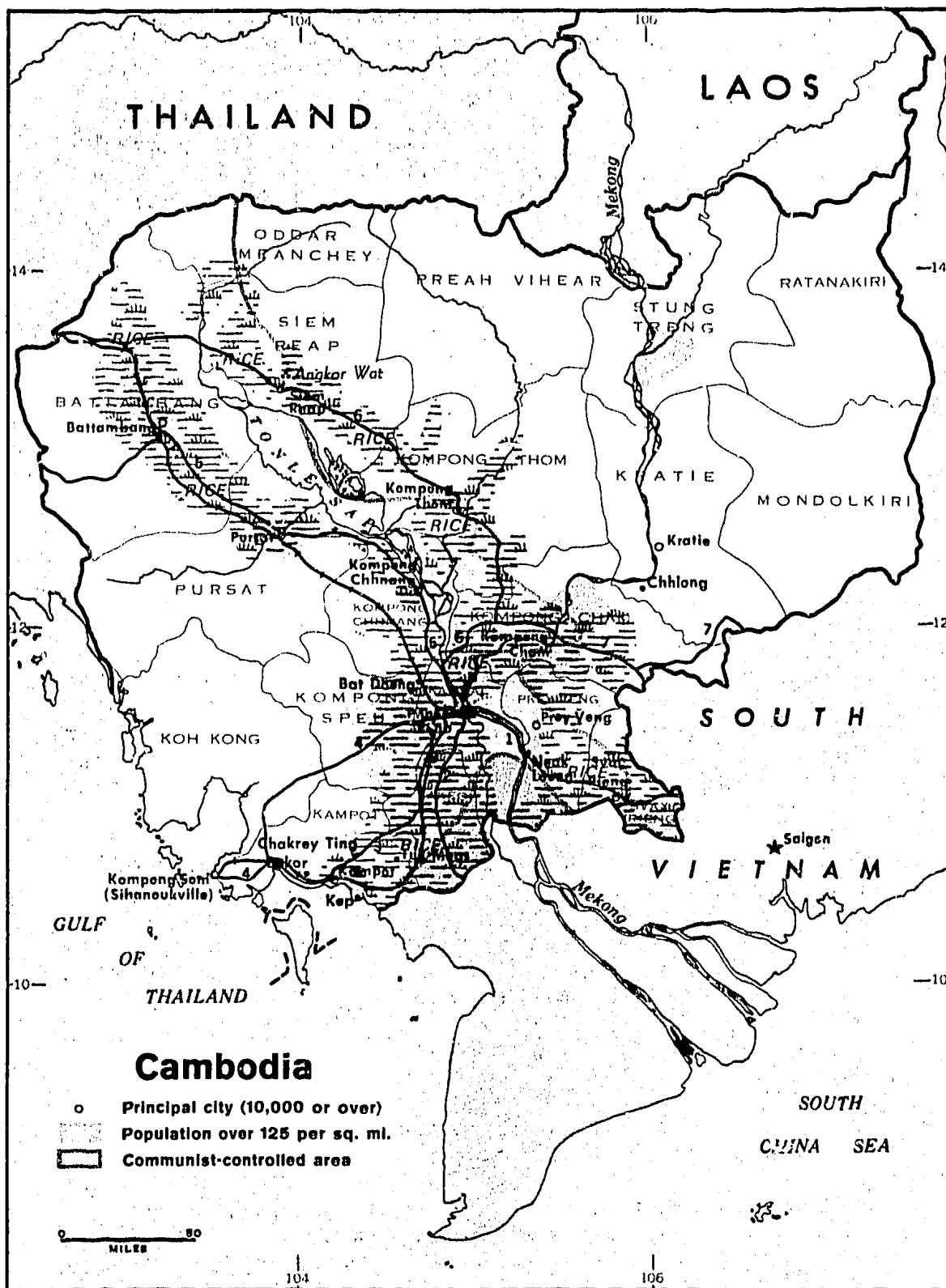
22. The security situation has been relatively stable for several months, and our projections through June 1971 assume no significant changes. The situation is difficult to describe in terms of territory actually held by Communist or Cambodian government forces (see the map). There are vast areas of the country that are "controlled" by neither side. But even in areas under government control, lines of communication frequently are disrupted by enemy harassment. In all, government-controlled areas contain about 70% of the Cambodian population (including refugees) and rice production.

Agriculture

23. Climatic conditions have been particularly favorable for Cambodia's 1970/71 rice crop. However,

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because approximately 25% of the ricelands are in areas under nominal Communist control, and because the hostilities are believed to have caused a 20% reduction in planting, the rice harvest in government-controlled areas is expected to total only about 1.7 million tons of paddy. Allowing for a net influx of some 200,000 refugees to government-controlled areas, about 1.4 million tons of paddy would be needed for internal consumption requirements, leaving a potentially exportable surplus of some 150,000 tons of milled rice (see Table 1).

24. Two additional factors could have a considerable effect on the size of the rice surplus. Rice-growing areas under Communist control are likely to produce a surplus -- possibly amounting to more than 100,000 tons* -- in excess of the population's consumption requirements in 1971. This surplus is more than sufficient to meet the needs of Communist forces in Cambodia and the import requirements of those in rice-deficit areas of South Vietnam and southern Laos. Before the outbreak of hostilities, the Cambodian government provided about 20,000 tons of rice annually to the Vietnamese Communists. Current Communist requirements for Cambodian rice are probably of this same order of magnitude. Whether or not the Communists will permit movement of the remaining surplus to markets in government-controlled areas is uncertain. Moreover, even in those areas, surpluses may be reduced by spoilage losses resulting from a shortage of storage facilities.

25. Rubber production is expected to be negligible in 1971. Nearly all of the plantations are likely to remain in Communist-controlled areas, and few of the extensively damaged processing facilities could be repaired in time to have much effect on rubber exports before 1972.

26. Commercially important corn production will probably continue to be hampered by insecurity and ARVN operations in areas southeast of Phnom Penh. Corn exports will probably remain low. Throughout the country, production of fruits and

** This estimate is based on peacetime production capability. Actual surpluses may be much smaller as a result of the hostilities and enemy occupation.*

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Table 1

Cambodia: Production and Consumption of Milled Rice for 1971, by Area of Communist and Cambodian Control ^{a/}

	Thousands		Thousand Metric Tons					
	Estimated 1970 Population		Estimated 1970/71 Production		Estimated Consumption Requirements ^{b/}		Estimated Surplus or Deficit	
	GKR-Controlled Area	Communist-Controlled Area	GKR-Controlled Area	Communist-Controlled Area	GKR-Controlled Area	Communist-Controlled Area ^{c/}	GKR-Controlled Area	Communist-Controlled Area
Provinces under GKR control	2,225	0	430	0	355	0	75	0
Battambang	655	0	235	0	105	0	130	0
Koh Kong	45	0	5	0	5	0	0	0
Kompong Chhnang	325	0	65	0	50	0	15	0
Kompong Speu	365	0	65	0	60	0	5	0
Pursat	215	0	60	0	35	0	25	0
Autonomous municipalities ^{d/}	620	0	Negl.	0	100	0	-100	0
Provinces under partial GKR control ^{e/}	2,585	1,820	560	365	415	290	145	75
Kampot	285	120	80	35	45	20	35	15
Kandal	725	115	65	10	115	20	-50	-5
Kompong Cham	415	560	95	25	65	90	30	-65
Kompong Thom	55	280	15	70	10	45	5	25
Oddar Meanchey	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Prey Veng	325	255	85	70	50	40	30	30
Siem Reap	165	205	65	75	25	35	35	45
Svay Rieng	200	145	70	50	30	25	40	25
Takeo	415	140	85	30	65	20	20	5
Provinces under Communist control	0	320	0	30	0	50	0	-20
Kratie	0	150	0	15	0	25	0	-10
Mondolkiri	0	20	0	Negl.	0	5	0	-5
Preah Vihear	0	50	0	Negl.	0	10	0	-10
Ratanakiri	0	60	0	15	0	10	0	5
Stung Treng	0	40	0	Negl.	0	5	0	-5
Total	4,810	2,140	990	395	770	340	220	55
Consumption needs of approximately 400,000 refugees							-65	65
Potential surplus							155 ^{f/}	120 ^{f/}

^{a.} Data have been rounded to the nearest five. Because of rounding, components may not add to the totals shown.^{b.} Estimated at 0.16 metric ton per person annually.^{c.} Consumption requirements for indigenous Cambodians only.^{d.} Including Phnom Penh, Kompong Som, Bokor, and Kep.^{e.} Population and rice production are assumed to be distributed proportionately to areas of control.^{f.} This estimate was derived by projecting demonstrated peacetime production capability. Except for an estimated 20% country-wide decline in rice planting, it contains no other adjustment for the effects on rice production as a result of damage, enemy occupation, and refugee movements. Consequently, actual surpluses -- particularly in enemy-controlled areas -- may be much smaller.

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vegetables can be expected to remain more than adequate for internal needs, but transport dislocations are likely to cause occasional supply problems.

Industry

27. Industrial production is unlikely to exceed one-half of the 1969 level so long as the country's only cement and paper plants remain out of production and enemy interdictions to transport continue to interrupt the flow of raw materials to other factories and the distribution of their products to markets. The Cambodians have shown little capability to improve the situation. Consequently, no significant change is expected before mid-1971.

Exports

28. The anticipated drop in rice production, a sharp decline in industrial activity, and a continued absence of rubber production will significantly reduce the total output of goods in Cambodia, but the primary impact will be on exports. The total value of exports in 1971 probably will not exceed \$15 million, compared with an average of about \$80 million for the last five years. One should not rule out the possibility, however, that a few improvements in the transport situation -- for example, the repair of the Phnom Penh - Battambang rail line, improved security for shipping on the Mekong, or full cooperation from the Thais in moving rice by rail from Battambang to Bangkok for export -- could generate exports substantially in excess of \$15 million.

Imports

29. Abstracting from monetary developments and military requirements, import demand will also decline. Demand for imports of raw materials and capital goods will probably decline proportionately to industrial output and the level of construction, perhaps dropping by as much as 50%. Annual consumer requirements for imported essential goods -- based on prewar consumption levels and adjusted for the proportion of population in government-controlled areas -- are estimated to be about \$35 million to \$45 million. This figure includes rough allowances for imports of final goods and

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imports of raw materials for consumer goods industries. To the extent that these industries are disrupted by the war, the requirements for imports of finished goods will be increased and those for raw materials will be reduced, although by less. If the demand for nonessential consumer goods is also roughly proportional to population, total annual consumer import demand -- exclusive of military-related imports, such as petroleum -- will amount to \$45 million to \$55 million.

30. With exports a small fraction of normal levels, the supply of imports will depend on the availability of foreign aid and the extent of any drawdowns in foreign exchange reserves. As noted earlier, government reserve policy has been highly conservative. To date the shortfall in export earnings has been offset entirely by cuts in imports; foreign exchange reserves have not fallen. Although as stocks of imported goods become exhausted, the government can be expected to allocate foreign exchange from reserves, it probably is not prepared to draw these down drastically, even if it expected foreign aid to be forthcoming soon.

31. We assume, therefore, that a \$15 million reserve drawdown in the remainder of 1970 and one of similar magnitude in the first half of 1971 are the most that can reasonably be expected. Together with projected exports, the above reserve drawdowns give an import capacity of about \$45 million at an annual rate, or roughly what is needed to cover the essential requirements of the population. This level of foreign exchange supply, however, would be insufficient to pay for substantial amounts of military-related imports, for capital goods imports, or for consumer luxuries. Supplies of many goods would decrease or disappear, thereby further feeding inflationary pressures created by rising monetary demand.

Official Budget

32. Cambodia's budget has been increased enormously as a result of the war and mobilization. The latest revision of the official budget for calendar year 1970 calls for expenditures totaling some 18.2 billion riels (about \$328 million), almost twice the size of budgeted expenditures in 1969.

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The lion's share -- nearly two-thirds -- of the increase is allocated for defense purposes, primarily personnel costs. This estimate appears to be substantially inflated, however, possibly by as much as 5 billion riels.

Military Expenditures

33. Official military expenditure estimates are based on regular armed forces totaling 210,000 men throughout the last half of 1970. At mid-year, however, the actual strength of Cambodia's regular armed forces was about 110,000 and by mid-October apparently did not exceed 160,000. Furthermore, the Cambodians, themselves, say that they do not expect to reach 210,000 men before the end of the year. Even if the Cambodians were to achieve the 210,000-man goal by the end of 1970, the average for the six-month period would probably not be more than 160,000. Moreover, comparisons with past budgets indicate that the average grade projected by the Cambodians for the expanded 210,000-man army is not far different from that of the 1967 army of 35,000 men. Actually, the average grade should be lower, in view of the fact that most of the added personnel are untrained recruits.*

34. Nonpersonnel costs also appear to be inflated. In view of the fact that Cambodia's essential military hardware requirements are being met from foreign grants, the approximately \$100 million allocated for costs other than personnel in the 1970 military budget is highly suspect. An outlay of this amount would equal budgeted personnel costs, while, under peacetime conditions, operating costs amounted to only about 10% of personnel costs.

* Both the army and the civil service are highly paid compared with the rest of the population. On the basis of 1966-67 budget data, government employees, including military, comprised about 17% of the nonagricultural work force, yet they earned 45% of the accountable salaries paid by business and government. Moreover, a Cambodian private's real wage appears to be double that of his South Vietnamese counterpart and two-thirds above that of a Thai soldier. While high military pay makes some sense for a small army in peacetime, it may be impossible to sustain over a long period of large-scale mobilization.

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In the present circumstance, it seems more reasonable to assume that operating costs would range from 20% to 30% of personnel costs, depending upon the military posture assumed by the Cambodians and the availability of imported support equipment.

35. After adjusting for inflated projections of force levels and nonpersonnel costs, estimates of the effects on the monetary situation through June 1971 were derived as shown in Table 2. Depending upon whether the Cambodians achieve a military force level of 160,000 or 210,000 by 31 December, total military expenditures would amount to between 5.4 billion and 5.8 billion riels for calendar year 1970. These expenditures for the first half of 1971 would amount to between 4.2 billion and 5.8 billion riels, depending upon whether the force level was maintained at 160,000, as shown in the first example, or increased to 225,000, as shown in the second example.*

Civilian Expenditures

36. Civilian expenditures were budgeted at 6.1 billion riels for 1970. Personnel expenditures account for 3.8 billion riels, or 62% of the total, and will probably remain at the same annual rate in 1971. Material expenditures have been revised downward by the Cambodians and are now estimated at 2.1 billion riels for 1970 and also are projected to continue at that same annual rate for 1971. Capital expenditures have probably amounted to no more than 150 million riels thus far in 1970 and are expected to be virtually nonexistent from now until at least the end of June 1971.

37. In the revised budget for 1970, the Cambodians allocated an additional 1.3 billion riels to a miscellaneous category meant to cover civilian needs brought about by the war: repairs to roads, bridges, and railroad and telecommunications lines; refugee needs; and political, psychological, and cultural activities. In view of the fact that most refugee relief is being handled through humanitarian

* It should be noted that budgeted food costs for the paramilitary forces may also be inflated. They are not considered part of the regular forces and are provided a subsistence allowance only in the event they are forced to leave their local area in support of regular forces.

Table 2

Cambodia: Estimated Government Expenditures, Revenues,
and Net Changes in Liquidity

Million Riels

	January-December 1970		January-June 1971	
	Force Level I (160,000 Regulars 50,000 Paramilitary)	Force Level II (210,000 Regulars 50,000 Paramilitary)	Force Level I (160,000 Regulars 100,000 Paramilitary)	Force Level II (210,000 Regulars 150,000 Paramilitary)
Expenditures	11,360	11,935	7,537	9,125
Military expenditures	5,415	5,800	4,250	5,735
Personnel	3,835	4,200	3,030	4,120
Nonpersonnel a/	970	1,050	760	1,010
Paramilitary food allowance	550	550	460	605
Civilian expenditures	5,935	6,135	3,287	3,390
Personnel	3,800	3,800	1,900	1,900
Nonpersonnel	2,035	2,095	1,040	1,040
Capital	150	150	0	0
Other	100	100	400	400
Financing	11,360	11,935	7,537	9,125
Revenues	4,350	4,350	2,220	2,220
Import-related	1,500	1,500	750	750
Other	2,850	2,850	1,470	1,470
Adjusted budget deficit	7,010	7,585	5,317	6,905
Net change in liquidity	4,350	4,350	2,220	2,220
Cash deficit	4,500	5,400	5,370	6,905
Plus value of exports	1,650	1,650	400	400
Minus value of imports b/	2,500	2,500	1,250	1,250

a. Estimated at 33% of personnel costs.

b. Assumes a net foreign exchange inflow of \$15 million in 1970 and an additional \$15 million by 30 June 1971.

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aid programs and that repairs to bridges and the like have been minimal, more reasonable estimates are 100 million riels for 1970, increasing to 400 million riels in the first half of 1971.

Receipts

38. Budget receipts depend basically on imports and on the population under government control. In the first six months of this year, revenues amounted to about \$45 million and are expected to approach \$75 million to \$85 million by year's end. Assuming no foreign economic aid and a \$15 million drawdown in foreign exchange reserves in both 1970 and the first half of calendar year 1971, receipts from customs duties and sales and business taxes on imports would amount to about \$27 million in 1970 and \$14 million in the first half of 1971. Revenues from strictly domestic sources are estimated at 2,850 million riels for 1970 and 1,470 million riels for the first half of 1971, about 30% below normal levels.

Budgeted Deficit

39. The enormous increase in expenditures and the sharp decline in revenues (in the absence of foreign economic aid) yield a massive budgetary deficit for calendar year 1970 and the first half of 1971. The adjusted deficit for 1970 ranges from 7.2 billion to 7.6 billion riels, depending upon force levels. This estimate, while very large, is considerably below the official estimate of a 12-billion-riel deficit for 1970. For the first half of 1971, an additional budget deficit of between 5.4 billion and 6.9 billion riels can be expected.

Cash Deficit

40. Monetary data show that the actual cash deficit is running well behind even our budget projections. The actual cash deficit -- as measured by the increase in the government's debt to the central bank for the first nine months of 1970 (incurred largely since April) -- amounted to about 3 billion riels. Our adjusted budget calculations yield a deficit of about 5.6 billion riels in the same period. The difference probably mainly reflects delays in government payments. In some

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instances, military payrolls have been three and four months in arrears. Obviously, the delaying process cannot continue much longer. We expect the cash deficit to increase sharply during the next few months (to a monthly rate of between 600 million and 800 million riels during October-December) and to approximately equal the accounting deficit (an average monthly rate of between 900 million and 1,100 million riels) in the first half of 1971. This assumes no further change in the size of the unspent backlog of authorized expenditures after the end of 1970.

Money Supply

41. The budget deficit and an increase in private bank credit* caused the money supply to rise by 32% from January to August of this year, compared with an increase of 3.0% during all of 1969. The entire increase in the money stock was absorbed into currency in circulation, which rose by 46.7% while demand deposits declined by 4.2% over the same period.

42. During the next several months, budget deficits will increasingly dominate the monetary situation. Other influences will be relatively small. Even without foreign aid, exports would drop more than imports, a deflationary factor. The impact of the demand for private credit is difficult to assess. With the disruption of industrial and construction activities and a smaller farm population, as well as a seasonally weaker farm demand in the latter part of the year, demand for private credit for productive purposes may decline before year's end. On the other hand, demand for private credit for speculative purposes seems to have been strong in the last few months and may continue to increase. These two influences will tend to cancel out.

43. The monetary effects of these various factors are projected in Table 2. The money supply would increase in the range of 3.8 billion to 4.6 billion riels before the end of the year and between 4.5 billion and 6.1 billion in the first six months of next year.

* During January-August 1970, total bank credit increased by 42%, to 4,820 million riels.

SECRET

Prices

44. If the price level rose in proportion to the money supply, it would increase about 40% in the second half of this year and another 50% or so in the first half of 1971. Declines in production and imports could result in even higher rates of inflation. On the other hand, the availability of large rice stocks and declines in local demand for certain goods under conditions of insecurity could hold price rises below the growth of the money supply.

45. The stock of money has risen very rapidly since March, yet strong upward pressure on prices was not evident until August, and the increase in the August price level could be at least partly explained by shortages of meat arising from sharply increased military activity during the month in the immediate environs of Phnom Penh. The government has successfully kept the price of rice down by selling off stocks and can continue to do so for a long time because large stocks are still available. Another important influence seems to have been consumer psychology. Apparently, consumers have been willing to hold larger cash balances, possibly because of the unavailability of certain consumer items, the paucity of preferred investment opportunities, and, most importantly perhaps, a reluctance to purchase durable goods and other luxury items where insecurity prevails. The latter reaction to security has been observed on various occasions, including the aftermath of the Tet offensive in South Vietnam.

46. If, however, the military situation markedly improved, it seems likely that consumers would regain their confidence, and the rate of spending would increase. Under these circumstances, the government would have to take steps to mop up this excess purchasing power by raising taxes.